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ROTH 401(k) OPTION AVAILABLE FOR EMPLOYER SPONSORED PLANS

The Economic Growth and Tax Relief Act of 2001 (EGTRRA) included a provision effective for taxable years beginning after December 31, 2005 permitting a 401(k) plan to include qualified Roth contributions. Now if an employer sponsored plan permits Roth 401(k) contributions, employees have an opportunity to make after tax Roth contributions as elective deferrals to a 401(k) plan**.**

Employees at various income levels may benefit from a Roth 401(k) account**.** Employees with adjusted gross incomes lower than $160,000 filing a joint return, $110,000 for other employees and zero for those employees filing as married separate are currently eligible to contribute to Roth IRAs. However, the maximum amount that these employees can contribute is very limited, i.e., $4,500 ($5,000 for employees over age 50) in 2006. Higher income employees have not had the ability to contribute to Roth IRAs because of the above income limits. By adopting Roth 401(k)s, these highly compensated employees will be able to contribute up to $15,000 per year in 2006 ($20,000 if a participant is eligible to make age 50 catch-up contributions) without future income tax liability on the earnings from these Roth 401(k) contributions.

In addition, contributions to a Roth 401(k), unlike Roth IRAs, may be matched by a participant's employer on a pre-tax basis, like matching contributions on non-Roth 401(k) elective deferrals. These matching contributions, however, will not be excluded from gross income and will be subject to all normal distribution restrictions placed on regular pre-tax elective deferrals. Thus, distributions are only permitted when the participant satisfies two "Qualifying Events". First, attainment of age 59 ½, death, disability, severance of employment, termination of the plan and for hardship. Second, the distribution must occur after a five-year period. The Roth 401

*(See **Roth 401(k)** on page 2)*

DOES YOUR DEALERSHIP'S RETIREMENT PLAN REQUIRE AN AUDIT?

The Employee Retirement Income Security Act of 1974 (ERISA) includes a requirement that certain retirement plans are audited annually by an independent public accountant. The audited financial statements are then submitted to the U. S. Department of Labor (DOL) along with the annual information return, commonly referred to as Form 5500. Failure or refusal to file audited reports in accordance with federal regulations may result in the imposition or assessment of penalties. Penalties may also be imposed or assessed in the event the required audited statements are not filed in a timely manner.

Large Plans
The number of the participants in the plan is the primary criteria for determining whether a retirement plan needs an audit. Generally, plans with 100 or more participants at the beginning of the plan year are subject to the annual audit requirement. Participants include the following:

- Current employees who actively defer wages in a 401 (k) plan or participate in some other voluntary savings plan
- Current employees who are

*(See **Audit** on page 2)*

NADA 2006 ISSUE

(*Roth 401(k) continued from page 1*)
(k) plan must contain a provision whereby distributions of tax-free earnings are prohibited until the contributions have been invested for 5 years. This withdrawal stipulation may have an influence on participants when deciding whether a Roth 401(k) plan is a good idea, especially when they are approaching age 59 ½ and plan to withdraw these funds in less than 5 years. If the distribution does not satisfy the requirements that will classify it as a qualified distribution, the earnings will be subject to tax, including the 10% penalty tax unless rolled over. The returned contributions are not subject to income tax since the participant has already paid income tax on these contributions.

While Roth IRAs are not subject to the minimum required distribution rules, the proposed regulations provide that Roth 401(k) contributions are treated as elective deferrals and are subject to the minimum required distribution rules while participants are alive. As such, it may be possible for participants in a Roth 401(k) plan to roll over their Roth 401 (k) account to a Roth IRA to avoid minimum required distributions during their lifetime.

There are numerous considerations that should be taken into account when deciding whether to classify a contribution as a traditional pre-tax contribution or an after-tax Roth contribution. Some considerations that need to be evaluated in determining the value and use of a Roth 401(k) as it applies to participants' circumstances are current age, tax bracket, years to retirement and cost of the contribution. As noted before, Roth 401(k) contributions are funded with after-tax dollars. This means that participants would have to pay the income tax on the wages required to fund the contribution now in order to reap the tax-free treatment upon withdrawal. For example a participant in a 25 % federal tax bracket would require $20,000 of wages to fund a $15,000 contribution ($15.000 contribution plus $5,000 income tax liability) while in a traditional 401(k) plan $15,000 of wages would get you a $15,000 contribution to the plan.

Under current law, a Roth 401 (k) will expire in 2010, unless Congress takes steps to extend the benefit. While there are no guarantees, most people believe that if the benefit expires, the current rules will apply to money already in these accounts, but no new contributions will be allowed.

This provision, available for years beginning in 2006, would be a favorable benefit that a dealer may provide to his/her employees. Your Auto Team America member firm will be able to assist you in explaining and implementing this provision to your existing deferred compensation plan.

TAX TIP

IMPORTANT PAYROLL REMINDER

Have you updated your employee's Elective Deferral Limits for your Defined Contribution Plan? If not, the limits are as follows for tax year 2006:

	Deferral Amount	Over Age 50 "Catch-Up"	Total With "Catch-Up"
401(k)	$15,000	$ 5,000	$20,000
Simple IRA	$10,000	$ 2,500	$12,500

For other Defined Contribution Plan limits or additional information on Defined Contribution Plan options for your dealership, contact your local ATA member firm.

(***Audit** continued from page 1*)
eligible to receive employer contributions, including matching and/or profit sharing contributions
- Current employees who are eligible to participate in the dealership's plan but choose not to do so
- Retired or separated (terminated) employees who are receiving or are entitled to receive benefits in the future
- Deceased employees' beneficiaries receiving benefits or who are entitled to receive benefits in the future

Given the above definitions of a retirement plan participant, it is conceivable that although a dealership's active employee count is less than 100, the retirement plan may still require an audit. This would occur in the event that the accounts of terminated employees, retired employees and beneficiaries entitled to future benefits cause the dealership to surpass the participant count threshold triggering the audit requirement.

For newly established plans that have a short plan year of seven months or less, employers may elect to defer, but not eliminate, issuance audited financial statements. In this case, audited financial statements would be required after completion of the first full plan year.

Dealerships with plans approaching the size that require an audit should contact their retirement plan's third party administrator or benefit plan attorney regarding compliance with the automatic rollover provision regulations. Plans in compliance with this regulation would allow employers to automatically distribute a terminated participant's balance that is less than $5,000 to an individual retirement account (IRA) in the event the terminated employee fails to tell the employer where to direct distribution of the retirement plan account balance. This will help to reduce the participant count.

Small Plans

In certain instances, a plan with less than 100 participants may be required to submit audited financial statements along with its annual DOL filings. A plan, however, will be eligible for an audit waiver provided that it meets certain requirements. The small pension plan audit waiver regulation stipulates the following:

- At least 95% of the plan's assets as of the end of the preceding plan year must be qualified plan assets, as defined by ERISA. Additionally, any person who handles assets of the plan that do not constitute qualified plan assets must be bonded in accordance with ERISA requirements.
- The administrator must include certain information in the plan's summary annual report, in addition to that which is ordinarily required to be disclosed.
- Furthermore, the retirement plan administrator in response to a request by a participant or beneficiary, without charge to the participant or beneficiary, must make available for examination, or furnish copies of statements received from regulated financial institutions holding or issuing the plan's qualifying assets and evidence of the required fidelity bond.

It is important that dealerships closely monitor their retirement plan's participant count and that investments are in accordance with regulations governing retirement plans. By doing so, dealerships will assure compliance with ERISA rules and avoid the imposition or assessment of significant penalties. If you have questions regarding the audit of your retirement plan please contact your local Auto Team America firm.